

Message Text

LIMITED OFFICIAL USE

PAGE 01 LONDON 03167 01 OF 02 241926Z
ACTION EUR-12

INFO OCT-01 ISO-00 SS-15 NSC-05 ONY-00 /033 W
-----242002 031539 /44-R

R 241912Z FEB 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 0951

LIMITED OFFICIAL USE SECTION 01 OF 02 LONDON 03167

E.O. L1652: N/A
TAGS: EGEN, UK
SUBJECT: OFFICIAL VISIT OF PRIME MINISTER CALLAGHAN
MARCH 10-11: UK ECONOMIC SITUATION AND PROSPECTS

REF: STATE 36387

HERE IS BACKGROUND PAPER ON ECONOMIC SITUATION REQUESTED
REFTEL. POLITICAL BACKGROUND PAPER IN SEPTEL.
BEGIN TEXT

1. THE UK RECENTLY COMPLETED ARRANGEMENTS TO DEAL WITH
THE ECONOMIC CRISIS OF LAST FALL THROUGH CREDITS ARRANGED
THROUGH THE INTERNATIONAL MONETARY FUND AND THE BANK FOR
INTERNATIONAL SETTLEMENTS AND A RELATED ECONOMIC PACKAGE.
THE COMBINATION OF NEGATIVE CIRCUMSTANCES WHICH HAD BEEN
BUILDING UP FOR A LONG TIME BUT REACHED CRISIS PROPOR-
TIONS IN SEPTEMBER AND OCTOBER INCLUDED A HIGH RATE OF
INFLATION. SLOW RECOVERY OF THE ECONOMY WITH A MINIMAL
INCREASE OF GNP. GOVERNMENT EXPENDITURES OVER 50 PERCENT
OF GNP, A HIGH FISCAL DEFICIT. A POST-WAR RECORD LEVEL
OF UNEMPLOYMENT, A SUBSTANTIAL BALANCE OF PAYMENTS
DEFICIT. AND A HIGH LEVEL OF FOREIGN FINANCIAL OBLIGA-
TIONS, INCLUDING FAIRLY LARGE SUMS IN VOLATILE FOREIGN
OFFICIAL HOLDINGS OF STERLING. EQUALLY BAD LONGER RUN
FACTORS INCLUDED CHRONIC LOW INVESTMENT. POOR MANAGEMENT,
OVERMANNING AND LOW LABOR PRODUCTIVITY, ZIG-ZAG
LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 02 LONDON 03167 01 OF 02 241926Z

ECONOMIC POLICIES BY SUCCESSIVE GOVERNMENTS. AND UN-
CERTAINTIES OVER THE FUTURE OF THE MARKET ECONOMY AS THE
ROLE OF THE GOVERNMENT GROWS. THE LEFT WING OF THE
LABOUR PARTY. WITH ITS COMMITMENT TO EXPANDING SOCIALIST
POLICIES AND PROGRAMS, ALSO HAS ADVERSELY AFFECTED
BUSINESS CONFIDENCE. DESPITE A RELATIVELY EFFECTIVE
INCOMES POLICY WHICH HELPED BRING THE ANNUAL RATE OF

INFLATION DOWN FROM 26 PERCENT IN THE SUMMER OF 1975 TO AROUND 14 PERCENT IN SEPTEMBER 1976, THESE FACTORS LED TO A WIDESPREAD LACK OF CONFIDENCE IN STERLING. WHICH FELL FROM \$2.30 IN EARLY 1975 AND \$2.02 IN MARCH 1976 TO UNDER \$1.60 IN NOVEMBER. HIGH NOMINAL INTEREST RATES PERHAPS HELPED TO CHECK THE DRAIN OF FOREIGN EXCHANGE RESERVES, BUT AT THE PRICE OF ADDING AN OBSTACLE TO DOMESTIC ECONOMIC GROWTH. THE FINANCIAL AUTHORITIES' INTERMITTENT INTERVENTION COST BILLIONS OF DOLLARS BUT WAS INEFFECTIVE IN STABILIZING THE RATE AND AFFECTED THE OUTFLOW ONLY TEMPORARILY AS FOREIGNERS LOST CONFIDENCE IN THE UK'S ABILITY TO MANAGE ITS ECONOMY.

2. THE PACKAGE OF ECONOMIC MEASURES AGREED WITH THE IMF AND ANNOUNCED IN DECEMBER INCLUDED, PRINCIPALLY. UNDERTAKINGS TO REDUCE GOVERNMENT BORROWING OVER THE NEXT TWO FISCAL YEARS AND TO LIMIT DOMESTIC CREDIT EXPANSION. MOST OF THE BORROWING REDUCTION IS TO BE ACHIEVED BY SPENDING CUTS, INCLUDING PROPORTIONATE CUTS IN THE DEFENSE BUDGET. ALONG WITH SOME EXCISE TAX INCREASES. THE MONEY IS TO BE MADE AVAILABLE IN STAGES PROVIDED BRITAIN MEETS THE AGREED PUBLIC SECTOR BORROWING LIMITS AND CREDIT EXPANSION TARGETS.

3. THE SECOND ARRANGEMENT. AGREED IN JANUARY THROUGH THE BIS, PROVIDES A SAFETY NET OF \$3 BILLION TO COVER THE VOLATILE ELEMENT OF OFFICIALLY HELD STERLING BALANCES. THIS ARRANGEMENT IS INTENDED TO HELP THE UK ACHIEVE AN ORDERLY REDUCTION IN THE RESERVE CURRENCY LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 03 LONDON 03167 01 OF 02 241926Z

ROLE OF STERLING AND IN THIS CONNECTION TO FACILITATE THE FUNDING OF PART OF OFFICIAL STERLING BALANCES. IT IS CLOSELY RELATED TO THE ARRANGEMENTS WITH THE IMF, WHICH INCLUDE AN UNDERSTANDING THAT BRITISH INTERVENTION IN THE STERLING MARKET WILL BE DESIGNED TO MAINTAIN STABILITY IN THE MARKET WHILE KEEPING EXCHANGE RATES AT A LEVEL CONSISTENT WITH A COMPETITIVE POSITION FOR BRITISH MANUFACTURES. THE U.S. PARTICIPATION IN THIS ARRANGEMENT. BY THE FED AND THE TREASURY'S EXCHANGE STABILIZATION FUND. IS \$1 BILLION. WITH AN ADDITIONAL \$500 MILLION SHORT-TERM SWAP AVAILABLE DURING 1977.

4. THE EFFECT OF THIS PROGRAM AND THESE ARRANGEMENTS HAS BEEN TO STABILIZE THE POSITION OF STERLING FOR THE TIME BEING AT AROUND \$1.70 AND TO GIVE THE BRITISH

LIMITED OFFICIAL USE

NNN

LIMITED OFFICIAL USE

PAGE 01 LONDON 03167 02 OF 02 241926Z
ACTION EUR-12

INFO OCT-01 ISO-00 SS-15 NSC-05 ONY-00 /033 W
-----242001 031540 /44

R 241912Z FEB 77
FM AMEMBASSY LONDON
TO SECSTATE WASHDC 0952

LIMITED OFFICIAL USE SECTION 02 OF 02 LONDON 03167

GOVERNMENT A BREATHING SPACE TO CONTINUE ITS EFFORTS TO
DEAL WITH BRITAIN'S PROBLEMS. THE GENERAL STRATEGY
WHICH THE CALLAGHAN GOVERNMENT IS FOLLOWING IS TO TRY TO
RESTRAIN PAY INCREASES AND OTHSW PRICE FACTORS IN ORDER
TO BRING DOWN INFLATION, RESTRAIN GOVERNMENT AND
CONSUMER EXPENDITURES AND SHIFT RESOURCES INTO INDUSTRY,
PARTICULARLY INTO INDUSTRIAL INVESTMENT, WITH A VIEW
TOWARD DEVELOPING A MORE COMPETITIVE INDUSTRIAL
STRUCTURE AND EXPORT LED GROWTH.

5. WE CONSIDER THIS A SOUND STRATEGY; INDEED THERE
SEEMS NO SENSIBLE ALTERNATIVE. AND THE DIFFICULTIES ARE
DIFFICULTIES OF IMPLEMENTATION MORE THAN CONCEPT. ONE
OF THE PROBLEMS IS WHETHER MORE CAN BE DONE TO INSPIRE
THE BUSINESS CONFIDENCE AND CREATE THE INCENTIVES
NECESSARY TO A REAL EXPANSION AND IMPROVEMENT IN THE
INDUSTRIAL SECTOR. ANOTHER IS WHETHER A SATISFACTORY
LEVEL OF WAGE RESTRAINT CAN BE MAINTAINED. THE GOVERN-
MENT HAS POLITICAL DIFFICULTIES IN DEALING WITH BOTH OF
THESE PROBLEMS. THE PRIME MINISTER HAS INDICATED HIS
INTENTION OF PERSONALLY TAKING CHARGE OF INDUSTRIAL
POLICY, PERHAPS WITH A VIEW TO UNDERLINING THE IMPORTANCE
OF PROGRESS. AND HAS BEGUN TO TAKE A DIRECT ROLE. BUT IT
IS HARD TO SEE, BEYOND SOME POSSIBLE PSYCHOLOGICAL
LIMITED OFFICIAL USE

LIMITED OFFICIAL USE

PAGE 02 LONDON 03167 02 OF 02 241926Z

EFFECT, WHAT HE WILL BE ABLE TO DO. WITH A CONTINUING

HIGH LEVEL OF INFLATION AND TWO YEARS OF GENERAL SUPPRESSION OF DIFFERENTIALS. WAGE RESTRAINT BECOMES INCREASINGLY DIFFICULT. AND THE TUC HAVE SERVED NOTICE THAT THEY WILL NOT DISCUSS ANOTHER PACKAGE UNTIL THEY CAN SEE THE CONTENT OF THE NEXT BUDGET, TO BE ANNOUNCED IN APRIL. THE GOVERNMENT'S SUPPORT OF WORKER-DIRECTOR LEGISLATION PROPOSED IN THE BULLOCK COMMITTEE REPORT HAS BEEN A NEW NEGATIVE FACTOR IN THE BUSINESS ATMOSPHERE. ON THE OTHER HAND, INTEREST RATES HAVE COME DOWN SUBSTANTIALLY FROM THE NOVEMBER HIGH.

6. EVEN IF THE GOVERNMENT'S STRATEGY IS REASONABLY SUCCESSFUL, THE ROAD AHEAD REMAINS DIFFICULT; UNEMPLOYMENT WILL STAY HIGH. INFLATION WILL OUTPACE WAGE INCREASES FOR A TIME. AND THERE WILL BE SOME BELT TIGHTENING. HOWEVER, INCREASING FLOW OF NORTH SEA OIL IS A BRIGHT SPOT IN THE PICTURE OF THE FUTURE: REDUCED DEPENDENCE ON FUEL IMPORTS MAY ALLOW THE CURRENT BALANCE OF PAYMENTS TO MOVE OUT OF DEFICIT BY THE END OF THIS YEAR AND A SURPLUS IS EXPECTED IN 1978. END TEXT.

ARMSTRONG

LIMITED OFFICIAL USE

NNN

Message Attributes

Automatic Decaptioning: Z
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: HEAD OF GOVERNMENT VISITS, BRIEFING MATERIALS
Control Number: n/a
Copy: SINGLE
Sent Date: 24-Feb-1977 12:00:00 am
Decaption Date: 22 May 2009
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977LONDON03167
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Expiration:
Film Number: D770064-0919
Format: TEL
From: LONDON
Handling Restrictions:
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770214/aaaaalzc.tel
Line Count: 192
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: 3d6ac1bf-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: ONLY
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: ONLY
Reference: 77 STATE 36387
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 14-Mar-2005 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3242629
Secure: OPEN
Status: NATIVE
Subject: OFFICIAL VISIT OF PRIME MINISTER CALLAGHAN MARCH 10-11: UK ECONOMIC SITUATION AND PROSPECTS
TAGS: PINT, PFOR, UK, US, (CALLAGHAN, JAMES)
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/3d6ac1bf-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009